BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
RECLAIMED ISLAND LANDS COMPANY)

Appearances:

For Appellant: Johnson and Harmon, its Attorneys

For Respondent: Chas. J. McColgan, Franchise Tax Commission

Submitted on memoranda without oral hearing

O P I N I O N

This appeal is made pursuant to Section 25 of the Bank and Corporation Franchise Tax Act (Chapter 13, Statutes of 1929, as amended) from the action of the Franchise Tax Commissioner in overruling the protest of the Reclaimed Island Lands Company, a corporation, to his proposed assessment of an additional tax in the amount of $3,600.04 for the taxable year ended December 31, 1936, based upon the income of the corporation for the year ended December 31, 1935.

Included in the, Appellant's income for the year ended December 31, 1935, was the sum of $7,435.20, representing interest from bonds of the Chicago Joint Stock Land Bank, and the sum of $126,501.24, representing a profit to the Appellant from the sale of bonds of the Denver Joint Stock Land Bank which it acquired and sold during the year. The proposed assessment resulted from the inclusion by the Commissioner of the foregoing items in the measure of Appellant's tax for the taxable year ended December 31, 1936.

The Appellant contends that the inclusion of these items in the measure of the tax is prohibited by Section 26 of the Federal Farm Loan Act of 1916, as amended, which provides that bonds issued under the provisions of the Act "and the income derived therefrom shall be exempt from Federal, State, municipal and local taxation." We think a sufficient answer to this contention is afforded by the fact that the Bank and Corporation Franchise Tax Act does not impose a direct tax upon income but imposes a tax *upon* the privilege of doing business in corporate form, the tax for each year being measured by the net income of the corporation during the preceding year. That income which may not be taxed directly may be included in the measure of such a tax appears to be conclusively established by a number of decisions of the United States Supreme Court. (Flint v. Stone Tracy Co., 220 U.S. 107; Education Films Corp. v. Ward, 282 U.S. 379; Pacific Co., Ltd. v. Johnson, 285 U.S. 480.)

While mere citation of the Pacific Co. case, which was

concerned with the identical taxing statute involved in this appeal, would seem in itself sufficient to establish the propriet of the Commissioner's action, in view of the distinction which the Appellant attempted to draw between that case and the instant situation, we shall briefly discuss the holdings which we have cited. In each case the tax was measured by net income which had either been held judicially to be immune from a direct net income tax by the government whose taxing power was asserted, or was assumed by the court to have such an immunity, and in each the tax was upheld on the ground that it was not imposed upon such income but upon the privilege of exercising the corporate franchise. Thus, in Educational Films Corp. v. Ward, supra, at page 389, the court stated:

> While this court since M'Culloch v. Maryland, 4 Wheat. 316, 4 L. Ed. 579, has consistently held that the instrumentalities of either government, or the income derived from them, may not be made the direct object of taxation by the other, it has held with like consistency that the privilege of exercising the corporate franchise is no less an appropriate object of taxation by one government merely because the corporate property or net income, which is made the measure of the tax, may chance to include the obligations of the other, or the income derived from them. The constitutional power of one government to reach this permissible object of taxation may not be curtailed because of the indirect effect which the tax may have upon the other.
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> "The precise question now presented was definitely answered in Flint v. Stone Tracy Co., 220 U.S. 107, 162 et seq . .."

Pacific Co., Ltd. v. Johnson, supra, held that there could be included in the measure of the California Bank and Corporation Franchise Tax interest from improvement district bonds, even though it be assumed that such was immune from taxation under the State Constitution. The court, at page 489, stated the issue to be "whether the immunity is broad enough to secure freedom from taxation of a corporation franchise, to the extent that it is measured by tax exempt income." (Underscoring added. It then proceeded to answer this question in the negative, large on the authority of the Flint and Educational Films cases.

Appellant argues that these cases are not relevant, inasmuch as the immunity here asserted is one which arises by virtue of express statutory provision and not merely by implication or by reason of the source from which the income is derived. In our opinion, however, the manner in which the tax immunity is created or is found to exist is immaterial. In view of the holding in each of these cases that the tax was not upon the income, but upon the privilege of exercising the corporate franchise, and as such could properly be measured by income which could not be taxed directly, the Appellant's contention must be held to be without merit.

O R D E R

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED that the action of Chas. J. McColgan, Franchise Tax Commissioner,. in overruling the protest of the Reclaimed Island Lands Company, a corporation, to a proposed assessment of additional tax in the amount of $3600.04 for the taxable year ended December 31, 1936, be and the same is hereby sustained.

Done at Sacramento. California, this 15th day of November, 1939, by the State Board of Equalization.

Fred E. Stewart,, Member
George R. Reilly, Member
Harry B. Riley, Member

ATTEST: Dixwell L. Pierce, Secretary